No. 80-442

Supreme Court, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1980

BEN F. GARMAN,

Petitioner,

vs.

THE NORTHERN TRUST COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED[1]

1. Whether a defendant whose motion for dismissal under Rule 41(b) of the Federal Rules of Civil Procedure, made at the close of Plaintiff's presentation of his case at trial, is granted, is denied due process of law when an appellate court reverses the dismissal order and does not remand for further proceedings to allow the defendant to present his case in chief or any of his evidence in defense.

2. Whether the Court of Appeals exceeded its scope of review in not applying a clearly erroneous standard and in determining the credibility of witnesses and questions of intent where the trial court made no such determination.

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[1] Petitioner requests to reserve the right to raise the issue of the Court of Appeals interpretation of reliance in Section 17(a)(2) of the Bankruptcy Act, 11 U.S.C. §35(a)(2), though not a basis for this Petition.

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OCTOBER TERM, 1980

NO.

BEN F. GARMAN,

Petitioner,

VS.

THE NORTHERN TRUST COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The petitioner, Ben F. Garman, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered in this proceeding on April 29, 1980.

OPINION BELOW

The opinion of the Court of Appeals for the Seventh Circuit reversing the judgment rendered by the United States District Court for the Northern District of Illinois, Eastern Division entered on April 29, 1980 and not yet reported, appears in the Appendix hereto. The Court of

Appeals denied the petitioner's timely petition for rehearing *en banc* on June 23, 1980. The opinion of the District Court for the Northern District of Illinois, Eastern Division, not reported, appears in the Appendix hereto.

JURISDICTION

The Judgment of the Court of Appeals for the Seventh Circuit was entered on April 29, 1980. A timely petition for rehearing *en banc* was denied on June 23, 1980, and this petition was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

United States Constitution, Fifth Amendment:

"..., nor be deprived of life, liberty or property, without due process of law."

United States Constitution, Fourteenth Amendment, Sec. 1:

"..., nor shall any state deprive any person of life, liberty, or property without due process of law."

United States Code, Title 28 U.S.C. Rule 41(b) Federal Rules of Civil Procedure:

"... After the plaintiff, in an action tried by the court without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief ..."

STATEMENT OF THE CASE

The jurisdiction of the District Court sitting as a Court of Bankruptcy was invoked pursuant to 11 U.S.C. §11 investing such courts with original jurisdiction in proceedings under the Bankruptcy Act (11 U.S.C. 1 *et seq.*). Northern Trust Company, the respondent herein, filed a complaint to determine the dischargeability of the claimed $30,000.00 indebtedness of Ben F. Garman, the bankrupt and petitioner herein, contending that it had relied upon allegedly false financial statements made by the bankrupt, 11 U.S.C. §35(a)(2).

At the trial of the cause, the plaintiff in the proceedings and the respondent herein, called three witnesses to the stand to testify. The first two were its own bank officers, and the third was Ben F. Garman, the petitioner herein, as an adverse witness. These witnesses were cross-examined by the attorney for Ben F. Garman. The following day, without presenting any further evidence, the plaintiff rested its case. Thereupon, without presenting any of its own evidence[2], the defendant immediately moved for an involuntary dismissal pursuant to Rule 41(b) of the Federal Rules of Civil Procedure (28 U.S.C. Fed. Rule 41) which is incorporated into bankruptcy procedure by Bankruptcy Rule 741:

> THE COURT: Do you have anything else?
>
> MR. WEBB: No, Your Honor, the plaintiff rests its case at this time.
>
> THE COURT: All right.

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[2] Though the defendant was able and ready to present its evidence and proceed to offer some 20 exhibits into evidence had the motion been denied (Transcript of Proceedings, p. 6-10, March 28, 1977)

MR. CRANE: Your Honor, at this time the defendant would make a motion for a directed finding based on the—

THE COURT: All right. I would assume so that we have the record proper, you are calling the Court's attention to Rule 41 of the Federal Rules of Civil Procedure which is incorporated into bankruptcy procedure by Bankruptcy Rule 741.

This Rule 41 of the Federal Rules of Civil Procedure provides in sub-part "B" that after the plaintiff in an action tried by the Court without a jury has completed the presentation of his evidence, the defendant without waiving his right to offer evidence in the event that the motion is not granted may move for a dismissal on the ground that upon the facts and law the plaintiff has shown no right to relief.

Why should I grant your motion, Mr. Crane?

(Transcript of Proceedings, p. 4-5, March 29, 1977.)

The Bankruptcy Judge granted defendant's motion and dismissed the complaint. Upon appeal to the District Court, the Bankruptcy Judge's order was affirmed. The Northern Trust Company appealed to the United States Court of Appeals for the Seventh Circuit. There, the Court held that both the Bankruptcy Judge and District Court Judge had placed an "improperly stringent legal standard" upon the plaintiff and reversed the judgment of the District Court. Further, based upon its own findings that the defendant's testimony was "inherently incredible,"[3] the Court remanded the cause for entry of a judgment in favor of the Northern Trust Company. A timely petition for rehearing and suggestion for rehearing *en banc* was denied.

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[3] It should be noted that the portion of the Court of Appeals' Opinion concerning defendant's testimony seems to be largely based upon a deposition which was never offered or admitted into evidence at the trial of the cause. (Transcript of Proceedings, p. 2, March 29, 1977)

REASONS FOR GRANTING THE WRIT

1. THE DECISION BELOW CONFLICTS WITH THE EXPLICIT LANGUAGE OF RULE 41(b) OF THE FEDERAL RULES OF CIVIL PROCEDURE AND PROCEDURAL DUE PROCESS

Rule 41(b) of the Federal Rules of Civil Procedure provides in part:

> After the plaintiff, in an action tried by the court without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The Court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment against the plaintiff or may decline to render any judgment until the close of all the evidence.

In reliance upon this section, "without waiving his right to offer evidence," Ben F. Garman, the petitioner, moved for an involuntary dismissal of plaintiff's cause, after the Northern Trust Company rested. By reversing the dismissal order and remanding the cause for a judgment to be entered against Ben F. Garman, the United States Court of Appeals has, in effect, waived the defendant's right to offer evidence in direct contravention of the expressed language of Rule 41(b).

By suspending the operation of Rule 41(b) a court of review has placed a party in a worse position than had the motion for dismissal been originally denied. How can

it be said that the due process rights of a party to a fair hearing have been properly protected under such circumstances?

This decision has consequences of great import. If a defendant cannot rely on the expressed language of Rule 41(b), but must fear that a successful motion once reversed may deprive him of presenting his own case, the use of such motion practice shall cease, and the very purpose of Rule 41(b) shall be evaded. This purpose was clearly expressed in *Bach* v. *Friden Calculating Machinery Company,* 148 F2d 407, 410 (6th Cir. 1945).

> "It is clear it was intended by adoption of rules to relieve the defendant in an equity case of the risk of having his proof cut off if he failed on a motion to dismiss at the conclusion of plaintiff's evidence and that it was intended to give that trial court the power to weigh the evidence and draw inferences therefore at the conclusion of plaintiff's proof in both law and equity cases."
>
> . . . If the trial court committed error in this respect, on reversal the defendant clearly would have the right to proceed with the introduction of his evidence under the rule. Any other construction would lack common sense.

This Court has clearly acknowledged the due process rights of a party to a full hearing including the presentation of a defendant's evidence. (*Baltimore & O.R. Co.* v. *United States,* 298 US 349, 368-370, 80 Led 1209, 1224, 56 SCt 797 (1936); *In Re Oliver,* 333 US 257, 273, 92 Led 682, 694, 68 SCt 499 (1948), *Jenkins* v. *McKeithen,* 395 US 411, 429, 23 Led 2d 404, 421, 89 SCt 1843 (1968). Rule 41(b) of the Federal Rules of Civil Procedure specifically provides that a defendant's motion for dismissal does not waive those rights.

It is clear that had defendant, Ben F. Garman's motion been denied, it would have been improper for the trial court to enter a judgment at that time in favor of the defendant; the defendant would still be entitled to present his witnesses and his evidence to refute the plaintiff's case. Thus, the question then becomes whether it is proper for an appellate court to place the defendant in a less favorable position by reversing a dismissal order and directing a judgment in favor of the plaintiff than the defendant would have enjoyed had his motion been denied.

Byrd v. *Blue Ridge Rural Electric Cooperative Inc.*, 356 US 525, 1 Led 2d 953, 78 SCt 893, reh. den. 357 US 933, 2 Led 2d 1375, 78 SCt 1366 (1958), involved a directed judgment for the defendant upon the denial of plaintiff's motion to dismiss an affirmative defense. This Court analogized the situation to a defendant's motion for involuntary dismissal after plaintiff has completed the presentation of his evidence. Where a party relies upon the trial court's view of a statute, though improper, and does not go forward with his proof based on said reliance, he cannot be "penalized by the denial of his day in court to try the issue under the correct interpretation of the statute." (356 US 525, 533).

In *United States* v. *United States Gypsum Co.*, 333 US 364, 401-402, 92 Led 746, 68 SCt 525 (1948), this Court reversed a dismissal order and remanded the cause for further proceedings stating:

> As the order of dismissal came at the end of the government's presentation on appellee's motion to dismiss under Rule 41(b) of the Federal Rules of Civil Procedure, the order is reversed and the case remanded for further proceedings in conformity with this opinion.

2. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS AS TO THE PROCEDURE FOLLOWING A REVERSAL OF A DISMISSAL ORDER

By its decision in this cause, and its denial of the petition for rehearing in which *McKey* v. *Roetter,* 114 F2d 129 (7th Cir. 1940) was cited as precedence, the Seventh Circuit has placed itself at odds with the position of other circuits.

The Second Circuit has held that where a complaint was erroneously dismissed, the judgment "must be reversed and the cause remanded to afford the defendants an opportunity to offer their evidence." (*Gulbenkian* v. *Gulbenkian,* 147 F2d 173 (2nd Cir. 1945)). The trial would proceed as if the defendant's motion had been denied.

The Third Circuit has also held that a reversal of a dismissal order pursuant to Rule 41(b) is to be treated as though the motion had never been granted. Addressing itself precisely to this point in *Federal Deposit Ins. Corporation* v. *Mason,* 115 F2d 548, 552 (3rd Cir. 1940) the Court stated:

> It is thus seen that if the defendant's motion had not been granted by the district court they would have been entitled to proceed to offer evidence in their defense. Since we now hold that the order granting their motion was erroneous and must be reversed, it follows that the Civil Procedure Rules require that the defendants now be afforded an opportunity to offer their evidence.

Likewise, the Fifth Circuit has held that in such instances the action "must be remanded for further proceedings to allow the defendant to present his case." *White* v. *Rimrock Tidelands, Inc.,* 414 F2d 1336, 1340 (5th Cir.

1969). Nor does it matter that one of the defendants testify as an adverse witness, the defendants still have a right to offer their evidence should the dismissal order be reversed. (*Riegel Fiber Corp.* v. *Anderson Gin Company,* 512 F2d 784 (5th Cir 1975)).

The dicta from cases in other circuits also is contrary to the Seventh Circuit's Opinion. (*Whitley* v. *Powell,* 150 F2d 625 (4th Cir. 1946); *Island Service Company* v. *Perez,* 302 F2d 799 (9th Cir. 1962). Equally disturbing is the fact that the Seventh Circuit has decided several cases with seemingly inconsistent procedural holdings to the instant matter. (*See Criscuolo* v. *United States,* 250 F2d 388, 389-390 (7th Cir. 1957); *James Burrough Ltd.* v. *Sign of the Beefeater,* 540 F2d 266 (7th Cir. 1976)).

3. THE DECISION BELOW RAISES SIGNIFICANT PROBLEMS IN THE SCOPE OF REVIEW OF APPELLATE COURTS AND THE PRACTICE OF USING RULE 41(b) BY DEFENDANTS.

Does the scope of review of an appellate court encompass determining the credibility of witnesses and limiting the rights of defendants to offer evidence contrary to statutory provisions? Although this Court has advised courts of review against deciding factual issues *de novo* (*Zenith Corp.* v. *Hazeltine,* 395 US 100, 123, 23 Led 2d 129, 148, 89 SCt 1562, 1567 (1968)) and particularly in evaluating testimony drawing credibility into question, *Graver Tank and Mfg. Co.* v. *Linde Air Products Co.,* 336 US 271, 275, 93 Led 672, 676, 69 SCt 535, 537-38 (1949), nonetheless, there are occasions where appellate courts have seen fit to delve into this area. However, this problem is compounded when reviewing a dismissal order entered pursuant to a Rule 41(b) motion. This becomes obvious where, as in the instant cause, the appellate court reviews the testimony of the defendant as an adverse witness and

finds such testimony to be "inherently incredible," though neither of the lower courts so found,[4] and then precludes said defendant from presenting evidence to refute the *prima facie* case made by the plaintiff, by directing the district court to enter judgment against the defendant without further proceedings.

It would seem that the proper scope of review of a dismissal order entered at the close of the plaintiff's case should be limited to a determination as to whether the trial judge's order was clearly erroneous. Where the appellate court determines that the trial judge used an incorrect legal standard, the test should be, under the correct legal standard and weighing the evidence, did the plaintiff make a sufficient case to get past the Rule 41(b) motion. If the answer is in the affirmative, then the cause should be remanded to the trial court to enable the defendant to proceed with his defense.

The importance that this Court clarify the procedure of an appellate court reviewing a Rule 41(b) dismissal order cannot be understated. If the procedure of the Seventh Circuit in the instant cause is condoned, then there will be severe ramifications; defendants will no longer move for a dismissal of the cause of action after plaintiff rests for fear of waiving their rights to present their case.

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[4] The Bankruptcy Judge did not make a finding on the intent of Ben F. Garman, but stated:

> I appreciate Mr. Webb's (Plaintiff's attorney) comments about Mr. Garman's testimony though I think that your comments, Mr. Webb, do not necessarily state that or show that Mr. Garman did have the intent. However, I do not make my judgment on whether there was intent to deceive in this case. I looked more to the conduct of the bank in making the loan of November 1, 1973, in the amount of $30,000 to Mr. Garman. (Transcript of Proceedings, p. 62-63, March 29, 1977)

There was no necessity or good reason for the Court of Appeals to inquire into the credibility of the defendant's testimony in the instant matter. Deference should have been given to the trial judge who could hear and observe the demeanor of the defendant. Courts of review should be particularly reluctant to evaluating the credibility of witnesses (*Graver Tank and Mfg. Co. v. Linde Air Products Co.*, 336 US 271, 275, 93 Led 672, 676, 69 SCt 535, 537-38 (1945)), *Banks* v. *Siegel,* 181 F2d 309, 310 (4th Cir. 1950)).

The results of an appellate court failing to abide by such precautions is evident here; acting as a trial court it determined that the defendant's testimony was "inherently incredible" (a role which has been ascribed as the function of the trial court) and acting as an appellate court it reversed and remanded the case for judgment (the trial court could not have awarded judgment at the close of plaintiff's evidence even if the defendants' testimony was "inherently incredible"). The testimony referred to was the limited testimony of the defendant called as an adverse witness. The full testimony of defendant supported by exhibits, other evidence and witnesses was never presented in the trial court, in reliance on Rule 41(b) which specifically states such motion is made without waiving his right to offer evidence.[5]

The Court of Appeals, by acting as both the trial and appellate court, has effectively deprived the defendant of his procedural due process rights of a fair hearing—one where he could present his evidence and have his day in court. This Court must insure that such rights are not so flagrantly cast aside, whether one is an accused criminal,

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[5] Plaintiff's counsel had stipulated to the foundation of some 20 Exhibits defendant had intended to introduce had his motion been denied. (Transcript of Proceedings, March 28, 1977 pp. 6-10)

bankrupt or general civil litigant. Such half-trial adjudication against a defendant was not envisioned by the legislators in the adoption of Rule 41(b) and gnaws away at the doctrine of procedural due process as frequently expressed by this Court:

> A person's right to reasonable notice of a charge against him, and an opportunity to be heard in his defense—a right to his day in court—are basic in our system of jurisprudence. . . . *In Re Oliver,* 333 US 257, 273, 92 Led 682, 694, 68 SCt 499 (1948).

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Seventh Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX

In the

United States Court of Appeals

For the Seventh Circuit

No. 79-1631

IN THE MATTER OF: BEN F. GARMAN, Bankrupt.

THE NORTHERN TRUST COMPANY,

Plaintiff-Appellant,

v.

BEN F. GARMAN,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 75 B 1111—Hubert L. Will, *Judge.*

Argued February 19, 1980—Decided April 29, 1980

Before CASTLE, *Senior Circuit Judge,* PELL and TONE, *Circuit Judges.*

PELL, *Circuit Judge.* Section 17(a)(2) of the Bankruptcy Act of 1938, 11 U.S.C. § 35(a)(2), provides that an individual's debt shall not be discharged in bankruptcy if that debt or its renewal is the result of money obtained "in reliance [by the creditor] upon a materially false

statement in writing respecting [the debtor's] financial condition made or published . . . with intent to deceive. . . ." This appeal calls upon us to decide, *inter alia*, whether non-dischargeability is appropriate only where the creditor's reliance under § 17(a)(2) is "reasonable."

Ben F. Garman, the bankrupt, a life insurance salesman, had been a customer of the Northern Trust Bank (Northern) in Chicago since 1962. Between December, 1970, and March, 1973, Garman borrowed various sums from the Northern resulting in a total indebtedness on November 1, 1973, of $30,000. On that date, Garman executed a renewal note to the Northern for the entire outstanding amount.

There is direct and unimpeached testimony in the record that the Northern, at least in part, expressly relied upon three financial statements submitted by Garman in making these loans.[1] It is uncontested by Garman that these statements omitted listing approximately $50,000 in "claims" that Garman later listed in his petition for bankruptcy.[2]

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[1] There is no requirement that the creditor place exclusive reliance on the financial statement. Partial reliance is sufficient. *See Carini* v. *Matera*, 592 F.2d 378 (7th Cir. 1979); *Cunningham* v. *Elco Distributors*, 189 F.2d 87 (6th Cir. 1951).

[2] Garman's transactions with the Northern can be summarized in the following schedule:

	Date	Amount	Date of statement relied upon	Amount of claims omitted
1.	12/ 9/70	$ 5,000 (loan)	12/ 8/70	$49,800
2.	12/21/71	$ 4,000 (loan)	12/ 8/70	$49,800
3.	9/ 5/72	$ 7,500 (loan) $ 2,500 (renewal)	12/22/71	$51,170
4.	1/15/73	$15,000 (loan)	12/22/71	$51,170
5.	3/ 2/73	$ 5,000 (loan)	2/27/73	$51,170
6.	11/ 1/73	$30,000 (renewal)	2/27/73	$51,170

These claims, however, are recorded as having arisen prior to the time Garman filed the statements with the Northern. Had these amounts been included as potential liabilities in the statements, they would have substantially reduced Garman's net worth, in some instances to less than zero.

Upon Garman's failure to pay the $30,000 when due in April of 1974, the Northern filed suit against him for this amount in state court. On February 6, 1975, prior to judgment in the state court, Garman filed a voluntary petition in bankruptcy listing as unsecured claims to be discharged the $30,000 debt to the Northern as well as the $50,000 in claims not listed on his financial statements. The Northern filed a complaint to prevent the discharge of the $30,000 debt pursuant to § 17(a)(2), and a hearing was held on the issue before a bankruptcy judge on March 28 and 29, 1977. At the hearing, the Northern introduced the testimony of Charles S. Bishop, a Northern vice-president, who had approved most of the loans to Garman, and Carol King, a loan officer who had approved the November 1, 1973 renewal, regarding their reliance on the Garman statements.[3] The Northern also introduced the various notes and statements signed by Garman. Each financial statement provided that it was "a true and complete statement of my financial condition, and details relating thereto. . . . I agree that if any material change occurs I will immediately notify you, unless you are so notified you may continue to rely upon the statement hereon given." Bishop testified that had he known of the $50,000 in claims omitted from the statements, he would not have made the loans.

---

[3] Although King, unlike Bishop, did not specifically state that she had "relied" upon Garman's filed statements when approving the renewal, she did state she had "reviewed" the statements and Garman's credit file as a whole prior to granting her approval. Her reliance on the statements, which at the very least was a partial basis of her decision, is implicit in her testimony.

Garman, testifying as an adverse witness, conceded that he failed to list the $50,000 in claims on the financial statement, but maintained that the omission did not render the statements false. Our examination of his testimony leaves us with the firm conviction that not only was Garman an evasive witness, but that his testimony was inherently incredible. A few illustrations are sufficient to demonstrate our conclusion. One of the creditors listed on Schedule A-3 of the bankruptcy petition was a Dr. Solomon with the claim stated as being approximately $10,800. Garman's attention was directed to the statement at the bottom of the page of Schedule A-3 that "none of the foregoing indebtedness, listed above, are contingent, liquidated or disputed, unless otherwise stated." When asked about the debt to Solomon which had been listed in the schedule without qualification, Garman responded, "[Y]ou keep referring to a debt. We are talking about unsecured claims. I am not talking about any debt." This was followed by an assertion that when he "signed that statement [he] did not acknowledge that was a debt." The record does not indicate whether he was referring here to the bankruptcy schedule or to the financial statement. Either interpretation, however, would fail of verity. If he was referring to the schedule, it clearly refers to "indebtedness." On the other hand, if he was referring to the financial statements, which were signed in the early 1970's, the Solomon claim was not listed although on the schedule he listed it as having been incurred in October, 1968. When asked specifically about listing this item on the financial statements, he said, "It talks about contingent liabilities, sir. I did not have a contingent liability at that time." When the Solomon matter was pursued further, this non-illuminating colloquy followed:

Q. I will rephrase the question.

Mr. Garman, in examining the financial statements marked as Plaintiff's Exhibit Nos. 2, 4, and 7, could you tell me if, reflected on any one of those financial statements, is this claim of Dr. Solomon that is reflected on the bankruptcy petition, is it reflected on any one of those three financial statements?

A. I'm sorry, I can't answer the question.

I find the discrepancy between claim and liability. This is talking about a liability and this is talking about a claim.

Q. You are not answering my question.

A. I can't answer your question.

THE COURT: That is an answer.

The statement that he could not answer the question was repeated with regard to another item of indebtedness listed on the bankruptcy schedule as having been incurred in February, 1972, even though he was being shown a subsequent-in-time financial statement which clearly did not include the debt. On subsequent references to the financial statements, Garman admitted that items were not listed there but did appear on the bankruptcy schedule, including a $4,000 indebtedness to another bank resulting from various loans extended over the past five years, and a promissory note to an estate for $5,000 which related back to January 1968.

Professing that he was "a student of semantics," Garman periodically stated that he could not answer questions, stating on one occasion, "[Y]ou ask me about debts, on the other hand, you are talking about claims." When examined by his own counsel, Garman, in significant candor, related that it had been made clear to him when he was filing in bankruptcy that possible claims should be listed because once he had filed he could not go back and claim that he had forgotten them. His concern about not having

possible claims discharged in bankruptcy did not extend to an equal disclosure when he was borrowing money from Northern. Garman further testified that the unlisted items on the financial statements were not legal documents, they were just informal agreements, and that he did not feel that the word "debt" did "justice to what was involved here as the listing of a claim." The gist of his testimony with regard to a substantial amount of the unlisted items was that Garman would purchase, or would recommend purchase, of certain investments which would be bought with money from friends, and he would share in 50% of the gains but would be responsible for 100% of the losses. He testified he did not consider these as "debts" although he did concede that the $5,000 promissory note, which was also unlisted on the financial statements, was an exception. In sum, while he considered that he had to list all possible claims on the bankruptcy schedule, he felt no similar compulsion on the financial statements even though an answer was required on "other contingent liabilities." As early as 1970, however, he was aware of this part of the statement because he listed a contingent liability of $37,000 as an indorser on notes. Subsequent statements listed no contingent liabilities.

At the conclusion of the hearing, the bankruptcy judge issued no written findings and made no oral findings regarding the materiality of the omissions in the statements or Garman's intent when he filed the statements. Rather, the bankruptcy judge held that the Northern had failed to establish its entitlement to non-discharge of Garman's debt to it because it had not proved it had "reasonably relied" upon the statements. Although the bankruptcy judge's statements do not make clear whether he was basing his decision on a finding of no actual reliance or of no reasonable reliance, the district court on appeal held, correctly we believe, that "it is clear that the bankruptcy judge's dismissal was predicated upon his findings

of no reasonable reliance."[4] The district judge then affirmed the bankruptcy court, stating: "In addition to the requirement that the creditor actually relied, it is clear that § 35(a)(2) requires that the creditor's reliance must have been reasonable." Viewing what it held to be a finding of fact by the bankruptcy judge, the district court held that the finding that the Northern could not have reasonably relied upon these statements was not "clearly erroneous."

Initially, we note that § 17(a)(2), unlike its successor,[5] does not by its terms require a showing of "reasonable reliance" and requires only a showing of reliance in fact.[6] Nevertheless, Garman relies upon a number of decisions ostensibly requiring a showing of reasonableness. *Carini* v. *Matera*, 592 F.2d 378 (7th Cir. 1979); *Kentile Floors, Inc.* v. *Winham*, 440 F.2d 1128 (9th Cir. 1971);

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[4] As noted above, Bishop's testimony that he actually relied on the statements in making the loans was direct and unimpeached, and the bankruptcy judge stated "there is no reason to doubt anything that Mr. Bishop stated in answer to the questions in my opinion."

[5] Section 523(a)(2)(B) of the Bankruptcy Act of 1978 provides, in relevant part:

> A discharge under . . . this title does not discharge an individual debtor from any debt—for obtaining money . . . or an extension [or] renewal, by—use of a statement in writing—(i) that is materially false; (ii) respecting the debtor's . . . financial condition; (iii) on which the creditor to whom the debtor is liable for obtaining such money . . . or credit *reasonably* relied; and (iv) that the debtor caused to be made or published with intent to deceive. . . . (Emphasis added.)

[6] Whether the new § 523 will be subject to the same interpretation we apply today to § 17(a)(2) is a question that will have to await another day for resolution.

In re: Smith, 424 F.Supp. 858 (M.D. La. 1976); *In re: Adams,* 368 F.Supp. 80 (D.S.D. 1973); *Sweet* v. *Ritter Finance Co.,* 263 F.Supp. 540 (W.D. Va. 1967); *In re: Disbrow,* 20 Colliers Bankr. Cases 1149 (D.Ver. 1979); *In re: Ducote,* 4 Bankr. Ct. Dec. 943 (W.D. La. 1978); *In re: Gibbs,* 9 Colliers Bankr. Cases, 608 (M.D. Fla. 1976); *In re: Arden,* 2 Bankr. Ct. Dec. 204 (D.R.I. 1975); *Cash Finance Service, Inc.* v. *Haisch,* 173 So.2d 851 (La. Ct. App. 1965). We believe, however, Garman misinterprets these cases in arguing that they bar the Northern's requested relief.

Although some of the mentioned cases do, in fact, refer to "reasonable" or justifiable reliance as a requirement under § 17(a)(2), they do not require the court, as was done in the present case, to undertake a subjective evaluation and judgment of a creditor's lending policy and practices. These cases simply stand for the proposition that reasonableness is circumstantial evidence of actual reliance; that is, dischargeability shall not be denied where a creditor's claimed "reliance" on a "financial statement" would be *so* unreasonable as not to be actual reliance at all. The opinions relied upon either state this directly, *e.g., Smith, and see Adams* and *Sweet,* or the lack of actual reliance was implicit in the record. In *Arden,* for example, the court held that the creditor knew the alleged misrepresentation was false at the time the loan was made and therefore could not have "reasonably" relied on the "misrepresentation." The court's decision to allow discharge, furthermore, was based upon its holding that the creditor had failed to prove the debtor's intent to defraud. In *Sweet,* one debtor, the husband, could neither read nor write except to sign his name on the statement filled out and signed by his wife. The entire transaction was completed in "no more than two minutes" and the creditor, although charging 30% interest on a portion of the amounts lent, never asked any questions con-

cerning the listed assets or liabilities. The court noted the creditor was simply "taking advantage of a borrower's ignorance" and held that indications that the creditor was well aware of the unsound financial condition of the debtor yet exercised an "almost studied disregard for the truth . . . is enough in most instances to preclude a later claim by the loan company that its reliance on the false financial statement was reasonable." 263 F.Supp. at 542. In *Kentile Floors,* and *Disbrow,* as in *Sweet,* the creditor possessed information that conflicted with the apparent financial well-being portrayed on the debtor's financial statement. In *Cash Finance,* the statement was all but illegible and the court found that it was "obvious" that the list of debts in the statement was incomplete. In *Ducote,* the money was transferred to the debtor at the same time the first financial statement was submitted, thus indicating that "the loan had already been approved when [the debtor] filed the signed financial statement." 4 Bankr. Ct. Dec. at 944. *See also Gibbs and Sweet, supra.* In *Smith* and *Gibbs,* the debtor was a total stranger to the lender and the "financial statement," which was "nothing more than a typewritten statement on the stationery of the company whose financial status they purported to represent," *id.* at 862, was unsigned by the debtor. In *Carini,* this court simply stated, "And, of course, such reliance must be reasonable" while affirming the district court's finding of reasonable reliance. 592 F.2d at 381.

These cases present factual circumstances far different from the one before us here. Garman, the debtor, was a sophisticated businessman who had a longstanding and apparently successful business relationship with the Northern for many years prior to his default. *See, Carini,* at 381. The financial statements he signed did not on their faces indicate the presence of any material misrepresentations or omissions, showed his net worth well in excess

of the loaned amount, and affirmatively required him to notify the Northern in the event of any material change in his financial condition. *Compare, Disbrow.* Furthermore, the Northern had no information indicating that anything stated in the financial statements might be materially false.[7] In sum, there are no facts presented suggesting that the Northern utilized the financial statement simply as a "perfunctory device to be used to contest discharge, and not used to be relied thereon." 1A Colliers on Bankruptcy, ¶ 17.16 at 1636 n.17 (14th ed., 1979), was simply "burying its commercial head in the sand," *Arden, supra,* at 207, or that the Northern's reliance on the financial statements was so unreasonable as not to be actual reliance at all.

Garman protests, however, that to allow Northern to bar discharge in this case would defeat the well-established principle that the Bankruptcy Act "ultimately favors the debtor who invokes its protection." *In re: Schmelzer,* 350 F.Supp. 429, 435 (S.D. Ohio 1972), *aff'd,* 480 F.2d 1074 (6th Cir. 1973). This would be true, of course, in every case where discharge is denied, yet this has failed to preclude the denial of discharge in cases where § 17(a)(2) applied. We believe the Act was meant to discharge only the *honest* debtor from his debts, *Williams* v. *United States Fidelity & Guaranty Co.,* 236 U.S. 549, 555 (1915), and that the Act should be liberally applied

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[7] Although it is true Garman was in default on at least one of the loans at the time of the November 1, 1973 renewal, this does not necessarily indicate that the financial statement misrepresented his financial condition. This fact might well indicate that it was a poor business decision to grant the renewal at that time in that Garman apparently would be required to sell assets to repay his debt. *See* discussion in text, *infra.* However, whether or not it was a poor business decision is not the proper inquiry. Rather, the proper inquiry is whether the claimed reliance on the financial statement accurately to portray Garman's net worth in excess of the debt was so unreasonable as not to be reliance in fact.

to protect the bankrupt only in those cases where there is no intent to violate its provisions. *In re: Schwartz,* 133 F.2d 216, 217 (7th Cir. 1943); *Cunningham* v. *Elco Distributors,* 189 F.2d 87, 89 (6th Cir. 1951). As was stated by the Supreme Court in *Bruning* v. *United States,* 376 U.S. 358, 361 (1964):

> . . . petitioner [is not] aided by the now familiar principle that one main purpose of the Bankruptcy Act is to let the honest debtor begin his financial life anew. As the Court of Appeals noted, § 17 is not a compassionate section for debtors. Rather, it demonstrates congressional judgment that certain problems . . . override the value of giving debtors a wholly fresh start. (Footnote omitted.)

See also United States v. *Sotelo,* 436 U.S. 268, 278-79 (1977).

The bankruptcy and district judges' analyses of the present case, in fact, illustrate the very problems potentially arising from their interpretation of the above mentioned cases. Indeed, their analyses did not address whether the Northern's reliance *on the statements* was reasonable. Rather, they expressed their judgment on whether the decision *to loan Garman the money* was reasonable.[8] They did not hold that the financial statements

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[8] An excerpt from the transcript of the bankruptcy hearing is indicative:

> The Court: The way I look at reliance if you rely on a piece of paper then it has to be that you are able to make a proper business decision.
>
> * * *
>
> What if I think the person who relied on [the statement] is a complete fool?
>
> * * *
>
> Mr. Webb (Northern's counsel): . . . Therefore, there is no question that the financial statement was relied upon. Now whether or not she should have relied upon it is the question

(footnote continued)

showing Garman's net worth in excess of the loaned amount was inherently unreliable; rather, they were concerned by the fact that the Northern would have based its decision to lend money on the net worth and nature of the assets of the debtor rather than the debtor's income.[9] However,

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(footnote continued)

your honor is asking?

The Court: Yes . . . I say that is *bad judgment.*

* * *

Mr. Webb: But the bank did rely upon it.

The Court: Then I fault their judgment. I fault their reliance . . . and I think that it is bad judgment if they relied upon this, even partially relied upon this.

* * *

The Court: The statement dated 2/27/73 does not justify the renewal or extension of credit to Mr. Garman of $30,000. . . . *It is just bad business conduct.*

* * *

The Court: I find it difficult to impose on Mr. Garman the responsibility of the bank's actions in making these loans where I believe that the various statements supposedly relied upon [by] the bank do not warrant in the court's opinion the extension of the credit. . . .

(Emphasis added.)

[9] At one point the bankruptcy judge stated:

Then I look to the financial statement and I say how can anyone look at this personal financial statement . . . which is the one dated February 27, and say on April 30, 1974 [the due date of the renewal note] Ben F. Garman will be able to pay $30,000.

* * *

Where is he going to get that money? He has $80,000 in—he is not going to sell his house. His cash in the bank, what is he going to do with that? He will keep that. He has life insurance cash value. Okay. On the back of it he says he has a loan of $5,000. Will he get another loan? All right, there is $5,000. He has a car. Is he going to sell his car? His coin collection. Are we going to ask him to sell his coin collection? He probably will not.

A lot, $20,000. I do not know what that lot is, whether it is a new home or an old home.

it is not the court's duty under § 17(a)(2) to second guess a creditor's decision to make a loan or to set loan policy for the creditor. If a lender chooses to let net worth rather than income be the determinative factor in loan decisions, it is not for the court to say that this is bad business policy requiring discharge of the resulting debt in bankruptcy. The present issue for the court is simply whether the bankrupt obtained credit, or a renewal, through the creditor's reliance on a materially false financial statement containing information apparently sufficient to obtain an accurate picture of the debtor's financial condition with regard to a reasonable decisional factor in the loan decision, filed by the debtor with the intent to deceive the creditor. The creditor need establish only its reliance in fact, although its claims to reliance cannot be so unreasonable as to defeat a finding of reliance in fact. Given this reliance, the court, with the benefit of hindsight, should not base its decision regarding discharge on whether *it* would have extended the loan. In the present case, the Northern's financial statement form requested sufficient information to obtain an accurate picture of the debtor's net worth, a reasonable decisional factor in the loan decision. To say the Northern should have looked to Garman's income flow instead of net worth is irrelevant to the § 17(a)(2) issues.

The bankruptcy and district judges were also concerned, however, with the fact that at the time the final renewal was granted on November 1, 1973, the most recent financial statement was more than seven months old. We also note that prior loans were granted in reliance upon financial statements that were slightly more than a year old. Although this fact also may raise questions regarding the business judgment shown in the decision to lend the money, we do not think this time lapse renders Northern's reliance on the statements so unreasonable as not

to be reliance in fact. In *Gerdes* v. *Lustgarden*, 266 U.S. 321 (1924), the debtor submitted a financial statement on January 5, 1920, containing, as in the present case, a statement that he would notify the creditor as to any material changes in his financial condition, and that the creditor could continue to rely upon the statement until so notified. Based upon this representation, the creditor, a bank, advanced funds in October and November 1920 and in February of 1921. Upon the debtor's bankruptcy, the bank moved to avoid discharge of the debt pursuant to § 14(b) of the Bankruptcy Act of 1910. The bankruptcy referee allowed the discharge holding that even if the bank had in fact relied upon the statement, "it had no right to so do, since in view of the financial depression prevailing in 1920, the 'reasonable time' for which the statement remained a 'continuing statement' had expired when the credits were extended." 266 U.S. at 324. The district court reversed, finding that the bank had a right to rely upon the statements, but the court of appeals reversed the district court judgment, holding that the lapse of time rendered the bank's reliance unjustified. The Supreme Court reversed the court of appeals, however, stating:

> The only essentials to the statutory bar . . . are (a) that the written statement was made for the purpose of obtaining credit; (b) that it was materially false; and (c) that credit was obtained upon it. If these are established, the vice inherent in the original falsity of the statement is not remedied by the lapse of time; and if the creditor extends credit upon such a false statement while it is still in force and binding upon the bankrupt, within the time in which he intended it should serve that end, it does not lie in his mouth to say that by reason of extrinsic circumstances the creditor was unjustified in relying upon it. In short, the lapse of time is only material in determining whether credit was extended within the period intended, while

> the statement was still binding on the bankrupt, and whether the creditor in fact extended credit upon the faith of the statement.

266 U.S. at 326.

We hold that the same conclusion is appropriate in the present case. Garman clearly filed the financial statements for the purpose of obtaining credit. The financial statements were materially false when they were filed. Finally, the creditor extended credit upon the faith of the statements.

The district and bankruptcy judges were also concerned, however, with the fact that the Northern took no steps to confirm or verify the information Garman set forth in his financial statements. They found, therefore, that any reliance the Northern placed in these statements was unreasonable. In *Carini, supra,* this court faced a similar contention and rejected it, as we do here. *Carini* involved a creditor who had the opportunity to verify the representations of the debtor's solvency made by the debtor in a written statement, and by the debtor's accountant orally. The creditor declined the opportunity "because he and [the debtor] were like brothers, and even had he seen [the verification], he would not have been able to understand [it]." *In re: Matera,* 436 F.Supp. 947, 949 (E.D. Wis. 1977). Nevertheless, this court affirmed the bankruptcy and district judges' refusal to discharge the debt, stating: "Taking into account . . . the close friendship between the parties, . . . the repetition of the false representations over a six-month span, and the other circumstances prior to the loan, the finding of reasonable reliance is supported by the evidence." 592 F.2d at 381. In the present case, we hold that the failure of the Northern to verify the information contained in Garman's statements was not so unreasonable as to justify a

finding that there was no actual reliance. Garman was a longtime customer of the bank and repeated his alleged misrepresentations over a three-year period. The statements themselves contain no information indicating that further investigation may be required, nor is there any allegation that further investigation would have uncovered the great majority of unlisted claims that were attributable to informal and oral arrangements between Garman and his friends. Furthermore, although a creditor is not entitled to rely upon an obviously false representation of the debtor, this does not require him or her to view each representation with incredulity requiring verification. "The law recognizes a duty of each to refrain from even attempted deceit of another with whom he deals, and the right of the latter to assume he will do so. . . ." *Jacobsen* v. *Whitely*, 138 Wis. 434, 120 N.W. 285, 286 (1909). Absent any facts reasonably indicating verification was necessary, we are not persuaded that the Northern's failure to verify rendered its reliance so unreasonable as to discharge Garman's debt.

One further point deserves mention. On appeal, the district court affirmed, *inter alia*, the bankruptcy judge's determination that because the November 1, 1973 renewal note extinguished all prior notes signed by Garman, the only circumstances to be evaluated under § 17(a)(2) were the circumstances surrounding the last renewal. To adopt such a position, however, is to hold that because the Northern failed to discover Garman's misrepresentation at the time of the renewal, all prior alleged misrepresentations by Garman were excused. This we refuse to do. Although the renewal note did, in fact, result in the repayment of the prior notes for bookkeeping purposes, it is clear that in actuality the "renewal" was exactly what its name implies, an extension of the time in which Garman was required to repay the pre-existing debt. Garman's

counsel acknowledged this when he conceded at the oral argument that the $30,000 renewal and the prior notes were all part of the same loan transaction.

Similarly, the fact that the November 1, 1973, renewal was initiated by the Northern rather than Garman is irrelevant to the instant issue. The fact remains that Garman signed financial statements stating that they could be relied upon until he informed the Northern otherwise. He cannot avoid liability on these statements simply because the Northern found that renewing the debt rather than immediately seeking its judicial remedies was in its interest. The Northern properly pleaded and appealed its contentions regarding the whole of Garman's outstanding debt, and the district court, therefore, improperly limited its review to only those circumstances surrounding the November 1, 1973 renewal.

Having held that the bankruptcy and district judges applied an improperly stringent legal standard in this case in finding that the Northern's reliance was "unreasonable," and therefore did not justify a bar to discharge, we see no reason to rule upon whether the bankruptcy judge's finding that Northern failed to meet the more stringent standard was to be reviewed under the "clearly erroneous" or some other standard. Our determination turns simply on a question of law.

Having thus determined that a reversal is necessary, our only remaining question concerns what course further judicial attention to this case should take. We have already set forth that the elements adverted to in *Gerdes* exist without dispute in the record of this case. The remaining question is the matter of "intent to deceive." We find guidance in *Carini, supra,* 592 F.2d at 380:

> In addition, the courts require a showing of fraudulent intent or moral turpitude on the part of the debtor,

> i.e., an intent to deceive. . . . These questions of knowing or reckless falsehood and intent to deceive are questions of fact, . . . and the bankruptcy court's findings on those issues are conclusive unless clearly erroneous. . . . (Citations omitted.)

Here, of course, we are not aided by a finding on this question of fact. Nevertheless, in view of the inherent incredibility of Garman's testimony, which we have previously noted, the continuing omissions in the context of the representations of completeness in the financial statements, in the words of *Carini, supra* at 380, "were grossly reckless at a minimum . . . Indeed, where, as here, a person knowingly or recklessly makes a false representation which the person knows or should know, will induce another to make a loan, intent to deceive may logically be inferred." *Id.* Here, we discern no reason for further extending the life of this litigation.

Accordingly, the judgment of the district court is reversed and the cause is remanded for the entry of a judgment in favor of the Northern Trust Company. Costs will be assessed against the defendant.

A true Copy:

Teste:

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Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

June 23, 1980

Before

Hon. Latham Castle, Senior Circuit Judge

Hon. Wilbur F. Pell, Jr., Circuit Judge

IN THE MATTER OF
BEN F. GARMAN,
Bankrupt,

No. 79-1631

THE NORTHERN TRUST CO.,
Plaintiff-Appellant,

vs.

BEN F. GARMAN,
Defendant-Appellee

Appeal from the United States District Court for the
Northern District of Illinois, Eastern Division
No. 75 B 1111
Hubert L. Will, *Judge*

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* Circuit Judge Philip W. Tone was a member of the panel which decided this case. However, Judge Tone resigned as a member of this court effective April 30, 1980.

This case is before the court on the petition for rehearing and suggestion for rehearing *en banc* filed in the above-entitled cause by Ben F. Garman, the defendant-appellee. On consideration of the petition for rehearing the court on its own motion excises and strikes from the opinion the following sentence appearing at pages 5-6 of the original slip opinion:

> As early as 1970, however, he was aware of this part of the statement because he listed a contingent liability of $37,000 as an indorser on notes.

The court further notes a question as having been raised in the petition for rehearing as to the propriety of the judgment of this court in ordering a remand for an entry of a judgment in favor of the Northern Trust Company. For the reasons stated in the opinion of the court, under the circumstances of this case the relief was, and still is, deemed appropriate. For precedent for comparable action in this circuit *see McKey* v. *Roetter* 114 F.2d 129 (7th Cir. 1940), *cert. denied,* 311 U.S. 691.

On further consideration of the petition and suggestion for rehearing *en banc,* no judge in active service having requested a vote thereon and both of the judges on the original panel who are still in active service having voted to deny rehearing, accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE

BEEN F. GARMAN,
Bankrupt,

NORTHERN TRUST COMPANY,

Plaintiff,

v.

BEN F. GARMAN,

Defendant.

Bankruptcy No. 75 B 1111

MEMORANDUM OPINION

This case is before the Court on plaintiff Northern Trust Company's ("Northern") application for review of an order of the bankruptcy court whereby plaintiff's complaint to determine the dischargeability of a $30,000.00 debt owed to the plaintiff was dismissed. Plaintiff contends that, where the unimpeached testimony of the bank's officers was that they had, in fact, relied upon the bankrupt's allegedly false financial statements in granting loans to the bankrupt, the bankruptcy judge committed clear error in holding that the bank did not reasonably rely upon the bankrupt's financial statements. We disagree, and affirm the bankruptcy court's ruling.

BACKGROUND

Between December 9, 1970 and March 2, 1973, Ben F. Garman borrowed various sums of money from and executed promissory notes in favor of Northern. Specifically, Garman borrowed $5,000 on December 9, 1970; $4,000 on December 21, 1971; $10,000 on September 15, 1972; $15,000 on January 15, 1973; and $5,000 on March 2, 1973. As a result of these loans, as of November 1, 1973, Garman had an unpaid balance of $30,000. On November 1, 1973, Garman executed a $30,000 renewal promissory note evidencing his debt to Northern, payable April 30, 1974.

On February 6, 1975, Garman filed a voluntary petition in Bankruptcy, and listed his $30,000 debt to Northern as an unsecured debt to be discharged. Northern filed a complaint to prevent the discharge of the $30,000 debt, alleging that Garman's debt, under 11 U.S.C. §35(a)(2), should not be discharged because that debt resulted from Northern's reliance upon materially false written financial statements submitted to Northern by Garman in order to obtain the loans totalling $30,000. Specifically, Northern alleged that Garman had, with an "intent to deceive," failed to list certain debts and/or contingent liabilities amounting to between $40,000 and $50,000 on several financial statements used to obtain the loans and particularly a financial statement of February 27, 1973 used to obtain the March 2, 1973 loan. Garman subsequently did list these debts and/or contingent liabilities as unsecured claims on his voluntary bankruptcy petition.

On March 28, 1977, the bankruptcy judge heard the testimony of Northern's witnesses in support of its claim that the $30,000 was not dischargeable under 11 U.S.C. § 35(a)(2). Two bank officers of Northern testified. Charles Seaman Bishop, a vice-president of Northern, testified as to his connection with the loans to Garman of December 8, 1970, December 21, 1971, September 5, 1972,

and January 15, 1973. Carol Ann King, a personal banking officer at Northern, testified as to her connection with the renewal loan to Garman of November 1, 1973. Garman also testified with respect to these loans from Northern and his reasons for failing to list certain debts and/or contingent liabilities on the financing statements which he had submitted to Northern.

At the conclusion of the plaintiff's case, Garman moved pursuant to Bankruptcy Rule 741, which incorporates Federal Rules of Civil Procedure 41(b) as applicable to bankruptcy proceedings, for dismissal on the ground that plaintiff had shown no right to relief. The bankruptcy judge granted Garman's motion on the ground that Northern's officer could not have reasonably relied upon Garman's earlier financial statements in making the $30,000 renewal loan on November 1, 1973.[1] In his oral statement

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[1] The bankruptcy judge stated:

> However, I do not make my judgment on whether there was intent to deceive in this case. I looked more to the conduct of the bank in making the loan of November 1, 1973, in the amount of $30,000 to Mr. Garman.
>
> As I review the various exhibits that have been admitted into evidence, particularly the personal financial statements, Plaintiff's Exhibits 2, 4, and 7, I can only surmise that the bank was digging a hole for itself; that the bank could not have reasonably relied on the statements that were filed with the bank.
>
> As to the statement Exhibit No. 2 which is dated December 8, 1970, the bank at that time made a loan to Mr. Garman in the amount of $5,000.
>
> Without much change in the financial worth the bank permitted Mr. Garman for some reason, and I say that reason was not reliance on this statement of financial condition, permitted Mr. Garman to have credit in the amount of $30,000.
>
> Whether prompt action by the bank prior to November 1, 1973, would have avoided a loss to the bank I do not know.

(footnote continued)

of reasons for dismissing Northern's complaint, the bankruptcy judge specifically noted that he did not rule on the issue of whether Northern had made a *prima facie* case as to whether Garman had had the requisite "intent to deceive." The judge also expressed grave doubts, without apparently ruling, that the alleged omissions from the financial statements were not material. The instant appeal followed.

MERITS

In this appeal, Northern argues that the only issue is whether it had established during its case-in-chief that it had relied upon certain false written financial statements submitted to it by Garman in order to obtain the loans. Specifically, Northern argues that numerous cases demonstrate that "a plaintiff alleging non-dischargeability under

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(footnote continued)

> But, I find it difficult to impose on Mr. Garman the responsibility of the bank's actions in making these loans where I believe that the various financial statements supposedly relied upon do not warrant in the Court's opinion the extention [sic] of credit in the manner that has been suggested by the Northern Trust Company.
>
> The materiality of the statements I find rather hard to believe because of my feeling that particularly the statement Exhibit No. 7, the statement dated February 27, 1973, does not justify the renewal or extention [sic] of credit to Mr. Garman of $30,000.

Tr. 62-64, Vol. II. While the judge's statement is susceptible of an interpretation that he found no *actual* reliance, in light of (1) the judge's repeated references to "justify" or "reasonable" in his statements above, (2) the judge's earlier, lengthy inquiry as to whether Northern's reliance upon the February 27, 1973 financial statement was reasonable, Tr. 32-44, Vol. II, and (3) the judge's willingness to accept the fact of King's actual reliance upon the February 27, 1973 financial statement, Tr. 34, Vol. II, it is clear that the bankruptcy judge's dismissal was predicated upon his finding no reasonable reliance on Garman's financial statements in the November 1, 1973 renewal loan.

11 U.S.C. §35(a)(2) sustains his burden of proof as to the reliance element of the statute if there is positive and unimpeached testimony from the lender that he relied upon a written financial statement of the debtor." We disagree.

11 U.S.C. §35(a)(2) provides that a debt of a bankrupt shall not be discharged in bankruptcy if it is a liability:

> for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made in any manner whatsoever with intent to deceive.
> . . .

Cases construing this statutory provision have held that, among the essential elements for a *prima facie* case under this statute, §35(a)(2) requires that the creditor have actually relied upon the debtor's representations. *In re Matera,* No. 77-2145, Slip Op. at 3 (7th Cir. 1979); *In re Houtman,* 568 F.2d 651, 655 (9th Cir. 1978); *In re Taylor,* 514 F.2d 1370, 1373 (9th Cir. 1975); *Sweet* v. *Ritter Finance Co.,* 263 F.Supp. 540, 543 (W.D.Va. 1967). In addition to the requirement that the creditor have actually relied, it is clear that §35(a)(2) requires that the creditor's reliance must have been reasonable. *In re Matera, supra,* Slip Op. at 3; *In re Smith,* 424 F.Supp. 858, 861-62 (M.D.La. 1976); *In re Adams,* 368 F.Supp. 80, 82 (D.S.D. 1973). As to this requirement that the creditor's reliance have been reasonable, we agree with the statements of the court *In re Arden,* 2 Bank.Ct.Dec. 204 (D.R.I. 1975):

> Sec. 17(a)(2) [11 U.S.C. §35(a)(2)] of the Bankruptcy Act specifically states that extensions or renewals of credit must be made "in reliance upon" false statements. . . .
>
> Though the word "reasonable" does not appear in Sec. 17(a)(2) in connection with reliance, it cannot

> be disputed that reliance must of necessity be reasonable. The element of reasonableness is implicit in the proposition that "[W]hile the Act . . . attempts to strike a balance between the disparate interests involved . . . it must be remembered that the Act ultimately favors the debtor who invokes its protection." *In Re Schmelzer,* 350 F.Supp. 429 (1972), *aff'd,* 480 F.2d 1074 (6th Cir. 1973). . . . It would clearly work against the conscience of this Court to allow recovery by money lenders in cases where their claims are clearly based upon unreasonable reliance.

The burden of proving the reasonableness of the creditor's reliance in a §35(a)(2) suit to prevent discharge must be upon the plaintiff-creditor, as it is with each other element of the plaintiff's case. *See In re Taylor, supra,* 514 F.2d at 1373; *Sweet* v. *Ritter Finance Co., supra,* 263 F.Supp. at 543. Positive and unimpeached statements from the lender's officers as to the lender's actual reliance are not necessarily sufficient, standing alone, to satisfy the plaintiff's burden that its actual reliance was reasonable.

Northern further contends that the bankruptcy judge clearly erred in holding that Northern had unreasonably relied upon Garman's financial statement in making the renewal loan of November 1, 1973.[2] On this appeal, the

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[2] Northern's statement of the issue presented on this appeal is slightly different from our reading of the bankruptcy judge's actual holding. Northern's "Issue Presented for Review" states:

> Did the Bankruptcy Court commit error when it dismissed the Plaintiff's Second Amended Complaint to Determine Dischargeability of Debt at the end of the plaintiff's evidence on the grounds that the plaintiff failed to establish reliance by it upon the defendant-appellee's false written financial statements in making certain *loans* to the defendant-appellee?

Brief for Plaintiff-Appellant, at 1 [emphasis added]. However, it is clear that the bankruptcy judge dismissed plaintiff's complaint

(footnote continued)

bankruptcy court's findings of fact are conclusive unless clearly erroneous. Bankr. Rule 810; *In re Matera, supra,* Slip Op. at 2. Under the circumstances of this case, we find the bankruptcy judge's determination that the plaintiff could not have reasonably relied upon the financial statement submitted by Garman on February 27, 1973 in making the renewal loan of November 1, 1973 to be a finding of fact, and subject, except for the consideration discussed *infra,* to review under the "clearly erroneous" standard of review. *See In re Matera, supra,* Slip Op. at 3 (applied "clearly erroneous" standard to bankruptcy court's determination that creditor reasonably relied). *See also In re Smith, supra,* 424 F.Supp. at 861. *Compare In re Sewell,* 361 F.Supp. 516, 519 (S.D.Ga. 1973).

Notwithstanding our conclusion that the bankruptcy judge's finding of no reasonable reliance is a finding of fact reviewable under the standard of Bankruptcy Rule 810, it is clear from a reading of the transcript that the bankruptcy judge's finding was based primarily upon his

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(footnote continued)
solely on the ground that plaintiff had failed to establish reasonable reliance with respect to the November 1, 1973 renewal loan. Moreover, this ruling of the bankruptcy judge was responsive to plaintiff's theory of the case at trial that it was the circumstances surrounding the $30,000 renewal loan of November 1, 1973 which were determinative of the dischargeability of Garman's $30,000 debt to Northern. Tr. 29-31, Vol. II. On the state of this record, and the narrow holding of the bankruptcy judge that Northern did not reasonably rely upon Garman's financial statements at the time of the November 1, 1973 loan, we construe Northern's appeal as essentially limited to challenging that holding. Accordingly, we do not consider the reasonableness of Northern's reliance upon Garman's written financial statements in making the December 9, 1970, December 21, 1971, September 5, 1972, January 15, 1973 or March 2, 1973 loans as before us on this appeal.

own inspection of the financial statements submitted by Garman, and not upon the live testimony of the three witnesses called by Northern.[3] Under such circumstances, where the judge's findings of fact are based upon documentary evidence, there exists substantial uncertainty in this and other circuits as to whether the "clearly erroneous" standard mandated by Federal Rule 52(a) is still applicable. *See Oscar Gruss & Son* v. *First State Bank of Eldorado,* 582 F.2d 424, 430-31 (7th Cir. 1978). At a minimum, however, under Federal Rule 52(a), findings of fact based on documentary evidence are "entitled to 'some deference' and cannot be set aside unless the appellate court can 'come to a definite and firm conviction that an error [was] committed in the findings.'" *Oscar Gruss & Son* v. *First State Bank of Eldorado, supra,* 582 F.2d at 431, *citing Mercantile National Bank of Chicago* v. *Howmet,* 524 F.2d 1031, 1035 n.3 (7th Cir. 1975), *cert. denied,* 424 U.S. 957 (1976). This statement as to the standard of review for findings of fact based on documentary evidence under Federal Rule 52(a) is equally applicable to the standard of review to be applied by this Court under Bankruptcy Rule 810. *See* Advisory Committee Note to Bankr. Rule 810.

Applying the above standard to the bankruptcy judge's finding that Northern did not reasonably rely upon Garman's financial statements of February 27, 1973 and earlier in making the November 1, 1973 renewal, six-month loan for $30,000, we cannot come to a "definite and firm conviction" that the bankruptcy judge erred. Contrary to

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[3] Bishop, Northern's vice-president who handled several of the pre-November 1, 1973 loans to Garman, testified to the absence of any monthly income and expense information on the financial statements completed by Garman, Tr. 79-81, Vol. I, and that the bank had possibly been "somewhat remiss" in not securing that type of information on its financial statements. Tr. 83, Vol. I.

Northern's assertion that there was nothing on the face of the financial statement nor any testimony from the two bank officers which would indicate that their reliance was unreasonable, several factors persuade us not to overrule the bankruptcy judge.

A review of the information contained on the February 27, 1973 financial statement,[4] which information was supplied by Garman apparently without any independent verification by Northern's officers, reveals that, as of that date, Gaman had net assets of $119,000, a net worth of $58,000, and a gross annual income of $40,000. The vast majority of Garman's assets were in an illiquid form. Moreover, $44,000 of his $58,000 net worth could be attributed to Garman's home (market value less mortgage). With respect to Garman's gross annual income, the financial statement nowhere indicates Garman's aftertax income, nor his estimated monthly income and expenses. Nor does it appear that Garman was asked to furnish such information before November 1, 1973, which information would have given a more accurate indication of his ability to repay a $30,000 loan at the end of a six month period. In addition to the seriously questionable adequacy of the information contained on the February 27 financial statement, it must be remembered that this statement was used some eight months *after* it was written and was used at a time when the bank must clearly have been aware of the problems Garman was having in making payments upon his previous loans. Under such circumstances, we cannot come to a "definite and firm" conclusion that the bank-

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[4] King testified that she had reviewed the February 27, 1973 financial statement prior to the renewal loan of November 1, 1973. Tr. 87-88, Vol. I. She did not testify to having reviewed any other financial statement. Thus, it is essentially the reasonableness of her reliance upon this financial statement which is at issue.

ruptcy judge erred when he concluded both that Northern unreasonably relied upon the February 27 financial statement in renewing the $30,000 loan on November 1, 1973 and that Northern should have taken additional steps to determine whether Garman could, in fact, pay the $30,000.

As previously indicated, the only issue presented to and decided by the bankruptcy judge was the reasonable reliance by Northern on the allegedly false financials in connection with the November 1 renewal and, accordingly, that is the only issue before us.

It is clearly inferable from the fact that Northern obtained no updated financial information in renewing the $30,000 loan on November 1, 1973 that it was not relying on the eight months old and older financial statements at all, but was simply renewing a loan which the borrower was currently unable to repay. Since this inference is consistent with the bankruptcy judge's conclusion, we cannot "come to a definite and firm conviction" that his findings are in error.

Neither case relied upon by Northern is to the contrary. *Household Finance Corp.* v. *Christian,* 98 N.W.2d (Wis. 1959), while procedurally similar to the instant case, is distinguishable. In that case, the court specifically noted that there were no "impeaching circumstances" nor anything "inherently improbable" in the fact that the plaintiff's manager had relied in making a loan upon the defendant's contemporaneous financial statement. 98 N.W.2d at 392, 393. In this case, however, the information contained on the face of the eight month old, February 27 financial statement is enough, in our opinion, to constitute "impeaching circumstances" with respect to Northern's reasonable reliance. *In re Bebar,* 315 F.Supp. 841 (E.D.N.Y. 1970), is inapposite. In *Bebar,* the district court straight-

forwardly applied the "clearly erroneous" standard to affirm a bankruptcy judge's decision resolving a witness credibility issue in favor of the bank officer and against the debtor. No issue was presented in that case with respect to the reasonableness of the bank's reliance upon the debtor's financial statement.

After careful consideration of the record, we cannot come to a "definite and firm" conviction that the bankruptcy judge erred. Accordingly, the bankruptcy judge's order dismissing the plaintiff's complaint must be affirmed.

An appropriate order will enter.

/s/ *Hubert L. Will*
United States District Judge

Dated: April 6, 1979